Supreme Court, U. S.
FILED
AUG 7 1980
MICHAEL RODAK, JR., CLERK

79-2077

IN THE

# Supreme Court of the United States

October Term, 1980

No. 79-2077

NEW YORK WATER SERVICE CORP.,
*Petitioner,*

v.

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
*Respondent.*

## BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

PETER H. SCHIFF
General Counsel

USHER FOGEL
Staff Counsel
Public Service Commission
of the State of New York
Empire State Plaza
Albany, New York 12223

*Attorneys for Respondent*
*Public Service Commission*
*of the State of New York*

July, 1980

BATAVIA TIMES, APPELLATE COURT PRINTERS
A. GERALD KLEPS, REPRESENTATIVE
20 CENTER ST., BATAVIA, N. Y. 14020
PHONE: (716) 344-2000

R

## TABLE OF CONTENTS.


| | Page |
|---|---|
| Statement | 2 |
| Argument | 4 |
| The doctrine espoused by this Court in *United* and its application by the Commission were constitutional, just and reasonable and should not be reversed or modified | 4 |
| Conclusion | 10 |


## TABLE OF CASES.


Banton v. Belt Line Ry., 268 U.S. 413 (1924) ..... 6
Case v. New York Central R.R. Co., 15 N.Y. 2d 150 (1965) ..... 7
Citizens Water—Supply Company of Newtown, 14 NY PSC 1353 (1974) ..... 2,3,9
FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944) .. 7,8
FPC v. United Gas Pipe Line Co., 386 U.S. 237 (1967) ..... 4,5,6,7,8,10
New York Edison Co. v. Maltbie, 244 App. Div. 436 9
New York Water Service Corp. v. Public Service Commission, 72 A.D. 2d 841 (1979) ..... 4,8,9
SEC v. Chenery, 332 U.S. 194 (1947) ..... 8
Western Pacific Railroad, 345 U.S. 247 (1953) ..... 7


## OTHER AUTHORITIES.


Article 78 of the New York Civil Practice Law and Rules ..... 4
Revised Rules of the Supreme Court of the United States, Rule 22 ..... 1

IN THE

# Supreme Court of the United States

October Term, 1980

No. 79-2077

NEW YORK WATER SERVICE CORP.,
*Petitioner,*

vs.

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
*Respondent.*

## BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

Respondent, pursuant to Rule 22 of the Revised Rules of the Supreme Court of the United States, files this brief in opposition to petitioner's request for the issuance of a writ of certiorari to review the order of the New York Court of Appeals entered April 1, 1980, denying leave to appeal from a determination of the Appellate Division of the New York Supreme Court (Third Judicial Department) unanimously confirming in all respects a rate order of the Public Service Commission.

## Statement

On October 24, 1977, petitioner, New York Water Service Corp. (NYWS), filed for an increase in its water rates and charges. NYWS is a wholly owned subsidiary of Utilities and Industries Corp. (U&I), and is made up of a number of divisions, one of which is the Merrick District, the only utility operation of the group.

NYWS does not file a separate Federal income tax return, rather it participates with its affiliated companies in the filing of a consolidated income tax return. In *Citizens Water - Supply Company of Newtown*, 14 NY PSC 1353 (1974), the Public Service Commission (Commission) considered the issue of applying non-utility tax losses in determining the regulated utility's tax allowance for rate purposes and enunciated the following general rule:

> . . . [O]nly those tax deductions properly attributable to the regulated operations under scrutiny should be used in determining a utility's tax liability for rate purposes. 14 NY PSC at 1356-1357.

However, the Commission set forth an exception to its general policy:

> . . . [I]t is not our intention that the general policy stated here should apply in a case in which the result would be unreasonable and unjust. Such a case might arise if, for example, the consolidated companies did not pay, and were not expected in the future to pay, *any* taxes or a permanently reduced level of taxes is to be expected. *Id.*

During the proceeding a Staff witness testified that from 1970 onwards NYWS, on a consolidated basis, paid minimal, if any, Federal income taxes and that the con-

solidated Federal income tax return for the fiscal year ending March 31, 1977 showed a balance of $26,712,030 in net operating carry forward losses available for use (Petitioner's Appendix, pp. A4, A17).

The Commission, after careful review of the record and cognizant of its decision in *Citizens Water,* concluded that in light of the past tax history of the consolidated group and the large balance of carry forward losses reported on the consolidated return NYWS would not incur a prospective tax liability, and therefore there was no need to provide an income tax allowance in rates (Petitioner's Appendix, p. A18).

In the company's prior rate proceeding, C. 26788, commenced in 1975, the Commission, in its *Order on Rehearing Adding Condition to Federal Income Allowance,* issued December 18, 1975, found a *prima facie* likelihood that the $630,000 income tax allowance granted to the company for the 1976 fiscal year would exceed the company's actual tax liability due to the consolidated tax position of the conglomerate which had resulted in minimal taxes from 1971 onward. The Commission ordered NYWS to establish a separate escrow account for Federal income taxes in a responsible banking institution and this account was to be credited on a monthly basis so as to accumulate $630,000 annually. In this manner, if actual taxes were less than the allowance, the difference could be credited to the benefit of the company's customers. No appeal was taken from this order (Petitioner's Appendix, p. A2).

In the instant rate proceeding, the Commission determined, on the basis of the record, that the consolidated group paid no taxes for 1976 and therefore ordered a por-

tion of the funds placed into the escrow account for tax purposes be refunded to the ratepayers over a two year period (Petitioner's Appendix, p. A16).

Petitioner sought review of the Commission's order by instituting a proceeding pursuant to Article 78 of the New York Civil Practice Law and Rules. The proceeding, commenced in the Supreme Court, Albany County, was transferred to the Appellate Division, Third Department which unanimously affirmed the Commission's determinations in all respects (*New York Water Service Corp. v. Public Service Commission*, 72 A.D. 2d 841 (1979)).

Petitioner's attempt to appeal as of right to the New York Court of Appeals was denied by order entered on February 12, 1980, upon the ground that no substantial constitutional question was directly involved (Petition, p. 5). After that denial, petitioner moved the Court of Appeals for leave to appeal. That motion was also denied (Petitioner's Appendix, p. A42). Petitioner filed a petition for a writ of certiorari with this Court on June 30, 1980.

## ARGUMENT

**The doctrine espoused by this Court in *United* and its application by the Commission were constitutional, just and reasonable and should not be reversed or modified.**

There is no merit to petitioner's contention that this Court's holding in *FPC v. United Gas Pipe Line Co.*, 386 U.S. 237 (1967), should be overruled or modified. In *United* this Court permitted the Federal Power Commission (FPC), under the proper circumstances, to apply non-jurisdictional losses to jurisdictional income in calculating the Federal income tax allowance to be provided in rates. As the Court explained, to provide a tax

allowance equal to what the utility would have paid had it filed a separate return, even when, in fact, a consolidated return is filed resulting in a lower tax liability, would permit the inclusion of a fictitious expense in rates. This result would not be just and reasonable and had to be rejected (386 U.S. at 244-45). The Court's decision was eminently fair and reasonable and petitioner has shown no good cause why it should, in any way, be modified.

The majority in *United* specifically rejected the contentions that petitioner is making here in support of its claim that a valuable asset of the consolidated group, its carry forward losses, is being confiscated and given away to the customers of the utility. As the Court explained in *United* at length (386 U.S. at 244), the decision to file a consolidated return there was a voluntary one taken by the group pursuant to the tax laws. The mingling of jurisdictional and non-jurisdictional activities enables the group to turn the losses of some companies into immediate cash by reducing the group's tax liability. However, once the actual tax expense is reduced, it must be recognized in the rate setting context. As noted by the Court at 386 U.S. at 244-245:

> . . . [W]hen the out-of-pocket tax cost of the regulated affiliate is reduced, there is an immediate confrontation with the ratemaking principle that limits cost of service to expenses actually incurred. Nothing in *Colorado Interstate* or *Panhandle* forbids the Commission to recognize the actual tax saving impact of a private election to file consolidated returns. On the contrary, both cases support the power and the duty of the Commission to limit cost of service to real expenses.

The consolidated group's right to use its tax losses was in no way impaired or diminished. It could continue to file a consolidated return and convert those losses into tax savings; however, its impact upon the utility's cost of service must be reflected in rates (386 U.S. at 247).

To argue, as petitioner does (Petition, p. 8), that the Court did not consider the issue of confiscation disregards the in-depth discussion in the Court's opinion noted above. Petitioner has merely affixed a different label to an old argument. Moreover, in *United Gas*, the Court's inquiry was as to whether the FPC's tax allocation formula was just and reasonable *(United, supra,* at pp. 241, 243, 246). A confiscatory rate by definition is one which falls below the zone of reasonableness. See, *Banton v. Belt Line Ry.*, 268 U.S. 413, at 422-424 (1924). The Court's finding of just and reasonableness precludes the possibility that the rate treatment is confiscatory.

Petitioner would have this Court ignore the fact that it will incur no tax liability and grant a tax allowance equal to what would have been paid had a separate return been filed. It was this particular situation which the Court found so unconscionable.

> Respondents insist that in making the allocation the Commission would violate the statute unless in every conceivable circumstance, including this one, United is allowed an amount for taxes equal to what it would have paid had it filed a separate return. In their view United should never share in the tax savings inherent in a consolidated return, even if on a consolidated basis system losses exceed system gains and neither the affiliated group nor any member in it has any tax liability. This is an untenable position and we reject it. Rates fixed on this basis would give the pipeline company and its

> stockholders not only the fair return to which they are entitled but also the full amount of an expense never in fact incurred. In such circumstances, the Commission could properly disallow the hypothetical tax expense and hold that rates based on such an unreal cost of service would not be just and reasonable (386 U.S. at 244-245).

Even the dissent in *United* would permit the application of non-jurisdictional losses under these circumstances (386 U.S. at 254-255).

*Case v. New York Central R.R. Co.*, 15 N.Y. 2d 150 (1965), cited by petitioner (Petition, pp. 7-8), dealt with the reasonableness of a corporate action taken by a Board of Directors, not any constitutional right to retain the benefit of tax losses for rate purposes. Additionally, there the parent, contrary to the situation in *United*, paid all the expenses of operating and maintaining the subsidiary's operations including property taxes (15 N.Y. 2d at 154).

Petitioner's reliance upon *Western Pacific Railroad*, 345 U.S. 247 (1953), is also misguided. First, the language cited appears only in a dissenting opinion and does not represent the majority position of the Court. Second, the Court remanded the case on purely procedural grounds (*Id.*, at 263-267).

The decision in *United* refers only to *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), in connection with its discussion concerning the mechanics of the Federal Power Commission's formula which allocated tax liability equitably between each regulated entity regardless of the source of regulation (*United, supra*, at 246); there is no

indication that its basic ruling which is challenged here is based on *Hope* at all, let alone an overly broad interpretation of *Hope,* as petitioner suggests (Petition, p. 8). The alleged conflict between *Hope* and *SEC v. Chenery,* 332 U.S. 194 (1947), which petitioner envisions (Petition, p. 9), is thus irrelevant.

The Commission's ruling under review was just and reasonable, founded on substantial evidence in the record and provides no basis for overturning the holding in the *United* case. In view of petitioner's past tax history, which had resulted in the payment of minimal, if any, taxes from 1971 onwards and the level of carry forward losses reported on the consolidated Federal income tax return for the fiscal year ending March 31, 1977, the Commission properly determined that no income taxes would be paid in the immediate future and that a permanently reduced level of taxes could be expected for the foreseeable future. As the Appellate Division concluded (72 A.D. 2d at 842-843):

> In our view, the past tax history of U&I, and particularly the size of the loss carry forward reported on its 1977 Federal income tax return (discussed hereafter), entirely justified respondent's conclusion that a 'permanently reduced level of taxes' could be expected in the future . . .
>
> Nor do we find any merit in the claim that the record lacks substantial evidence to support respondent's determination that there should be no future allowance for Federal income tax liability. Respondent accepted $26,000,000 as the amount of the currently available net operating loss carry forward, the sum reported on the consolidated 1977 Federal

> income tax return, rather than the $13,000,000 figure presented in U&I's financial report. Considering the standard for determining substantial evidence set forth in *300 Gramatan Ave. Assoc. v. State Div. of Human Rights* (45 N.Y. 2d 176), it was not improper for respondent to credit the higher amount portrayed by the return in concluding that NYWS would pay no income tax in the immediate future. We cannot overlook the fact that the record fails to demonstrate the reason for the discrepancy between the annual report and the tax return, especially since the burden of proving anticipated costs rests with the utility (*New York Edison Co. v. Maltbie,* 244 App. Div. 436).

The Commission's action was in direct conformance with its established policy. As the Appellate Division held, the Commission's order in *Citizens* clearly put petitioner on notice that if filing on a consolidated basis led to a significantly reduced level of tax liability the tax allowance provided in rates would have to be modified. Petitioner, however, continued to file a consolidated return. Accordingly, the Appellate Division noted (72 A.D. 2d at 842):

> Petitioner's contention of a change in established policy obviously rests on *its* interpretation of the *Citizens* exception . . . we find no deviation from its policy in fixing NYWS' new rates and note that petitioner's contrary interpretation was made at its own risk.

Petitioner's claim that it had been deprived of a valuable asset without due process of law was also properly rejected (72 A.D. 2d at 843):

> The due process argument advanced by petitioner may be answered in a like manner. U&I and NYWS chose to file consolidated tax returns with full knowledge of the existence of the *Citizens* exception, did not protest the 1975 orders, and, thus, were or

> should have been aware that the cost of service charges allowed for taxes might be lost if it were not so utilized in practice. The opportunity to make the decision to consume the 'valuable asset' of accumulated losses was all the process that was due.

The petitioner shows no reason why this Court should grant certiorari. All the arguments proffered in opposition to the reflection of non-jurisdictional losses were fairly and exhaustively considered and rejected by this Court in *United.* Both Courts below could find no substantial constitutional issue involved in this appeal. In the final analysis, this Court is called upon, for no good cause, to overrule a long-standing decision which has been followed consistently and any other ruling of this Court which may conflict with petitioner's desires.

## Conclusion

For the above reasons, this Court should deny the petition for a writ of certiorari.

Respectfully submitted,

PETER H. SCHIFF,
General Counsel,

USHER FOGEL,
Staff Counsel,
Public Service Commission
of the State of New York,
Empire State Plaza,
Albany, New York 12223,

*Attorneys for Respondent,*
*Public Service Commission*
*of the State of New York.*

July, 1980